IN THE HIGH COURT OF JUDICATURE AT BOMBAY

ORDINARY ORIGINAL CIVIL JURISDICTION

INCOME TAX REFERENCE NO. 467 OF 1987

M/s.Madhura Coats Ltd., as agents to J & P Coats Ltd., 278 Dr.D.N. Road, Bombay.) ...Applicant

V/s.

Commissioner of Income-tax, Bombay City II, Bombay.) ...Respondent

Mr.J.D. Mistry i/b. M/s.Kanga & Co. for Applicant.
Mr.Ashok Kotangle for Respondent.

CORAM : V.C. DAGA AND A.S. AGUIAR, JJ.

DATED : AUGUST 9TH, 2005.

ORAL JUDGMENT (PER A.S. AGUIAR, J.) :-

. The following questions of law arising from the order of the Tribunal in ITA No.4150/Bom/82 dated 31.7.86 for the assessment year 1978-79 have been referred to this Court for its opinion under Section 256(1) of the ITA Act, 1961 at the instance of the assessee, viz. M/s.Madhura Coats Ltd.

(1) Whether on the facts and in the circumstances of the case, the Tribunal was right in holding

that, considering the provisions of sections 47, 49 and 55 of the Act, the assessee-company was not entitled to exercise the option to substitute the fair market value as on 1st January 1964, of the shares of J & P Coats (India) Ltd., and A & F Harvey Ltd., as cost of acquisition of shares of Madura Coat Ltd. sold by it, under sec.55 of the Act in computing the capital gain or loss?

(2) If the answer to abovementioned question is in the negative, whether on the facts and in the circumstances of the case, the Tribunal was right in holding that for purpose of computing capital gains, the assessee-company was required to value the said shares sold by it on the basis of cost and not on the basis of yield method?"

2. The facts of the case are as under :-

. The assessee company which was incorporated in England, was associated with three Indian companies

viz.Madhura Mills Co. Ltd., A & F Harvey Ltd. and J & P Coats (India) Ltd. The assessee company had substantial share holdings in the aforesaid three companies and J & P. Coats (India) Ltd. was 100% subsidiary of the assessee company.

. Assessee company had acquired 18,500 and, 2,31,500 shares of A & F Harvey Ltd. in November 1962 and March 1965, respectively, aggregating 2.5 lakhs shares. In 1966, A & F Harvey Ltd. issued bonus shares as a result of which the assessee company became the owner and holder of 3.75 lakhs shares of A & F Harvey Ltd. at the end of 1966. The assessee company had acquired 2 lakhs shares of J & P Coats (I) Pvt.Ltd. before 31st December, 1963. Assessee company also acquired 1200 shares of Madura Mills Ltd. after 1.1.64.

. A new company known as Madura Coats Ltd. was incorporated at Madurai and the said three Indian companies were amalgamated with Madura Coats Ltd. with effect from 1.7.74 pursuant to the order of the Madras High Court. As a result of the amalgamation, the

Assessee company was allotted 56,01,913 shares in Madura Coats Ltd. in lieu of shares held by it in the three said amalgamating companies. Since the assessee company was a non-resident company it was required to disinvest 9,60,617 shares allotted to it of the newly formed company viz. Madura Coats Ltd. to the residents of India under the Foreign Exchange Regulation Act, 1973, which it did in the accounting year corresponding to the assessment year in question. The assessee company filed its return on 3.7.78 showing a long term capital gain of Rs.7,23,266 in respect of sale of said shares and thereafter filed a revised return on 3.10.78 declaring a long term capital loss of Rs.34,33,491/- in respect of the said shares.

3. Before the Income Tax Officer, the assessee company claimed that the shares of Madura Coats Ltd. sold by them were shares which became their property under the scheme of amalgamation in consideration of transfer of shares originally held by them in the three amalgamating companies, viz. J & P Coats (India) Ltd., A & F Harvey Limited and Madura Mills Co.Ltd. which

shares were acquired by them prior to 1.1.64 and claimed that in view of Section 47(vii) read with Section 49(2) and Section 55(2) of the Act, the assessee company in computing capital gains was entitled to substitute the fair market value as on 1.1.64 of such shares as cost of acquisition under Section 55(2) of the IT Act, and further, that the shares should be valued at the fair market value on the basis of yield method and not on the basis of cost of the shares.

4. The ITO by his order dated 12.8.81 rejected the claim of assessee company to substitute the fair market value as on 1.1.64 in computing the capital gain on the ground that the said shares sold by assessee company were acquired by it in 1974. The ITO also rejected the method of valuation of the said shares on the basis of of break up value or yield method, as suggested by assessee company, and computed the long-term gain on sale of the said shares at Rs.25,64,518/- on the basis of cost on the ground that the shares sold were acquired by the assessee company in 1974.

5. CIT(A) partly allowed the appeal of assessee company and held that the assessee company was entitled to substitute the fair market value of the said shares as on 1.1.64 sold under Sections 47, 49 and 55 of the Act. The CIT further determined the cost of the said shares at Rs.93,01,627/- instead of Rs.48,72,249/- which was determined by the ITO and also the method of valuing the said shares on the basis of yield method. In appeal by the revenue, the Tribunal held that considering the provisions of Sections 47, 49 and 55 of the Act, assessee company was not entitled to substitute the fair market value as on 1.1.64 in place of cost of the said shares while computing long-term capital gain. The Tribunal further held that for the purpose of computing capital gains, the assessee can only adopt the cost which it had paid and cannot adopt any other method for arriving at the cost of acquisition of the said shares.

6. The main issue for consideration before the Appellate Tribunal was whether the CIT(A) had erred in holding that the assessee is entitled to substitute the fair market value as on 1.1.64 in respect of the shares

held by it in the amalgamating company on 1.7.74 i.e. the date on which three Indian companies were amalgamated pursuant to which the assessee was allotted shares in the new company i.e. Madura Coats Ltd. in lieu of shares which it held earlier in three companies. The assessee's claim before the ITO was that the assessee could exercise the option for computing the capital gains taxes by adopting the fair market value as on 1.1.64 as the cost of the shares. The ITO rejected this claim of the assessee since according to him the shares were sold on 1.1.74, that is, the date of the amalgamation when the company came into existence. The company cannot value the shares as on 1.1.64 as those shares were not in existence on that date.

7. Learned Counsel Mr.Mistry appearing for the assessee company has pointed out that a plain reading of Sections 45 and 47(vi) indicates that 'amalgamation' does not amount to a transfer. It is further pointed out that the option to be exercised by the assessee is set out in Section 55(2) which reads as follows :-

Section 55(2) :- "For the purposes of sections 48 and 49, "cost of acquisition", in relation to a capital asset, -

(i) Where the capital asset became the property of the assessee before the 1st day of January, 1954, means the cost of acquisition of the asset to the assessee or the fair market value of the asset on the 1st day of January, 1954, at the option of the assessee;

(ii) Where the capital asset became the property of the assessee by any of the modes specified in sub-section (1) of section 49, and the capital asset became the property of the previous owner before the 1st day of January, 1954, means the cost of the capital asset to the previous owner or the fair market value of the asset on the 1st day of January, 1954, at the option of the assessee;"

8. Section 49 sub-section (1)(iii)(e) read with

Section 47 clause (vi) would indicate that where the capital asset became the property of the assessee on a transfer in a scheme of amalgamation of a capital asset, the cost of acquisition of the asset shall be deemed to be the cost for which the previous owner of the property acquired it, as increased by the cost of any improvement of the assets incurred or borne by the previous owner or the assessee, as the case may be. The cost of acquisition of the asset for the purpose of exercising option under Section 55 is given in Sub-section 2 of Section 55 which provides that for the purposes of Sections 48 and 49, "cost of acquisition", in relation to a capital asset would be as follows :-

> "Where the capital asset became the property of the assessee before the 1st day of January, 1964, means the cost of acquisition of the asset to the assessee or the fair market value of the asset on the 1st day of January, 1964, at the option of the assessee."

9. Learned Tribunal was of the view that since the

shares were not acquired before 1.1.64, clause (i) of sub-section (2) of Section 55 was of no avail to the assessee. It further held that clause (ii) of sub-section (2) of section 55 is also of no avail to the assessee as the modes of transfer under Section 49(2) do not come under the option available under Section 55(2)(ii). The Tribunal held that the cost of assets to the assessee would be the cost when the assets became the property of the assessee in any of the modes specified in sub-section (1) of section 49 and this refers back to the position when the assets were acquired originally by the assessee from the three former companies. The Tribunal has referred to the Judgment of this Court in the case of **Harish Mahendra, 135 ITR 191** wherein this Court held that the assessee had an option to adopt fair market value of subdivided shares which were acquired by the assessee before 1.1.54 as the cost of acquisition of the shares on the ground that the assets are same and therefore, the assessee had the option contained in clause (i) of Section 55(2) of the Act. However, the Tribunal has on facts distinguished the present case from that of **Harish**

Mahendra's case observing that the assessee company held the shares in three former companies and only after their amalgamation, the new company came into existence and it is this new company that issued new shares on 1.1.74. These shares, according to the learned Tribunal, were not in existence on or before 1.1.64 when they were received by the assessee after amalgamation of the companies. Assessee, therefore, had no option for asking that the shares be valued on the basis of its fair market value as on 1.1.64 as the cost of acquisition of the shares by the assessee.

10. It is the contention of learned counsel Mr.Mistry for the assessee that an amalgamation does not amount to transfer of shares and therefore, the shares that were allotted to the Assessee company after amalgamation were the same shares which the assessee company owned in the three erstwhile companies which were amalgamated. In support of his contention, he has referred to Judgment of the Madras High Court in the case of **H.F. Craig Harvey V/s. Commissioner of Income Tax reported in (2001) ITR Vol.244 578.** In the said

case, the Court observed as follows :-

> "The intention of the Legislature is clear that the transaction of allotment of shares held in the amalgamated company in lieu of the shares in the amalgamating company is not a transfer and there is only a change in the holding of shares in the amalgamating company to the amalgamated company. In other words, there is no transfer and the period of holding of shares in the amalgamating company is taken into account along with the holding of shares in the amalgamated company to determine the question whether the shares are long-term capital assets or short-term capital assets. The legal effect in treating the shares in the amalgamated company should be given full effect to and the legal fiction should be given a logical conclusion and it is impossible to treat the shares held in the amalgamated company as distinct and separate shares from the shares held in the amalgamating company. The cost of acquisition of shares of

the amalgamating company should be taken as the cost of acquisition for the purpose of determination of capital gains and the statutory right cannot be taken away by limiting the scope of section 49(2) of the Act and treating the shares held in the amalgamated company as a new asset. The intention of Parliament is to reduce the tax liability in the case of amalgamation and it is clear that under the provisions of section 49(2), the cost of the shares shall be deemed to be the cost of acquisition of shares in the amalgamating company.

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.... Once it is held that there is no change in the ownership, the assessee is entitled to exercise his statutory option to substitute the market value of the shares of the amalgamating company as on January 1, 1964, as the cost of

the shares under section 55(2)(i) of the Act. Section 49(2) is intended to determine the cost of acquisition of shares of the amalgamated company, but that does not take away the right of the assessee to exercise the option under section 55(2)(i) of the Act in adopting the market value of the shares of the amalgamated company as on January 1, 1964. We are of the opinion, by virtue of section 49(2) of the Act, the cost of the shares in the amalgamated company is deemed to be the cost of the shares of the amalgamating company and when the shares held by him in the amalgamated company were sold, the assessee had an option to take either the actual cost of the asset or the fair market value of the asset as on January 1, 1964. We therefore hold that the non-availability of an option under section 55(2)(ii) of the Act does not prevent the exercise of the option provided under section 55(2)(i) of the Act. The expression, "cost of acquisition" found in sections 48, 49 and 55 of the Act is a

compendious expression and in the context of levy of capital gains, the general principle of law relating to the cost determination of acquisition cannot be imported. Section 49(2) of the Act does not postulate the manner in which the cost of acquisition of shares in two amalgamating companies should be calculated. It merely declares that the cost of acquisition of the shares in the amalgamated company shall be deemed to be the cost of acquisition to him of the shares held in the amalgamating company. The cost of acquisition of shares held in the amalgamated company would be relevant at the time of transfer of the shares held by the assessee in the amalgamated company in the context of levy of capital gains and at that point of time, when the cost of acquisition of shares in the amalgamating company has to be determined, the assessee has an option either to adopt the actual cost of acquisition of shares in the amalgamating company or to adopt the fair market value of the shares as on January 1,

1964. The statutory right is not taken away by section 55(2)(ii) of the Act as the right is available to him under section 55(2)(i) of the Act. It is not possible to give a restricted meaning to the expression found in section 49(2) of the Act that the cost of shares shall be deemed to be the cost of acquisition of shares in the amalgamating company and that figure is an unalterable figure. In our opinion, section 49(2) of the Act and section 55(2)(i) of the Act should be read together."

11. The Madras High Court has placed reliance on the Judgment of this Court in the case of **Harish Mahendra V/s. Commissioner of Income Tax** wherein the Court was dealing with a case of determination of cost of acquisition of shares acquired before the 1.1.54, but subdivided after the date into shares of smaller denomination. In the said decision, the Court held that the option available under Section 55(2)(i) of the Act was not intended to be restricted only to the capital assets transferred by the assessee, but was available in

a case where the said capital assets had become the property of the assessee in any of the modes set out in section 55(2)(v) of the Act. This court held that even if the subdivided shares transferred by the assessee were not the same capital assets as constituted by the original shares from which the subdivided shares were derived, the assessee would be entitled to exercise its option contained in section 55(2)(i) of the Act and substitute the fair market value as on January, 1954, as the cost of the acquisition."

12. The Appellate Tribunal has distinguished the present case from that of **Harish Mahendra** on the ground that the shares sold were subdivided shares of the earlier company and therefore, the observation of this Court in the case were not of any assistance in deciding the present case.

13. We are of the view that the Tribunal was wholly misguided in arriving at its opinion. In fact, the present case is on a better footing than the case of **Harish Mahendra** where the nature of the shares

themselves had changed as the shares were subdivided. But despite this, this Court held that Section 55(2)(i) of the Act was not intended to be restricted only to capital asset transfer by the assessee but was available in a case where the said capital asset had become the property of the assessee in any of the modes set out in Section 55(2)(v) of the Act. If the option was available in such a case, the facts of the present case where the same shares held in previous companies were allotted to the assessee on amalgamation are facts which clearly entitled the assessee company to exercise the option and to have its shares valued on the basis of fair market value as on 1.1.64.

14. It is the submission of the learned Counsel for the assessee that there is no transfer of shares on amalgamation as the same shares are taken over by the new company formed on amalgamation.

15. In these circumstances, we are of the opinion that the Tribunal erred in its finding that since the new shares received by the assessee after amalgamation

of the three companies were not in existence on or before 1.1.64, the assessee had no option to ask that the fair market value of the shares as on 1.1.64 be treated as the cost of acquisition of the shares by the assessee. We, accordingly, answer the said question in the negative and in favour of the assessee.

16. The second question to be answered is "Whether the Tribunal has rightly held that for the purpose of computing capital gains, shares were required to be valued on the basis of cost and not on the basis of yield method?". It may be noted that the Tribunal gave its findings on appeal from the order of the CIT (Appeals) directing the ITO to take the fair market value of the shares sold on yield basis and not on break up value method for arriving at the cost of shares of J & P Coats (India) Ltd. The Tribunal declined to answer the question whether the CIT had erred in directing the shares to be valued on yield basis and not on break up value or cost basis on the ground that this is consequential to its order holding that the assessee company was not entitled to exercise the option of

adopting the fair market value. Since the assessee had no option for adopting the fair market value of those shares as on 1.1.64 for the purpose of valuation, there was no question of valuing the shares on yield basis (or on break up value method.) The Tribunal held that for the purpose of capital gain tax, the assessee can only go by the cost which he had paid. The finding of the Tribunal is self contradictory in that there could no question in acquisition in respect of shares which have, according to the Revenue, ceased to exist on amalgamation of the companies.

17. Since we have answered question no.1 in the negative and in favour of the assessee's claim to exercise the option to adopt the fair market value as on 1.1.64, it is necessary that the question whether the company was required to value the shares sold by it on the basis of cost and not on yield method, needs to be answered. It is the contention of the revenue that the assessee had acquired 18,500 and 2,31,500 shares of A & F Harvey Ltd. in November, 1962 and March 1965, respectively, aggregating to 2.5 lakhs shares and in

1966, A & F Harvey had issued bonus shares as a result of which the shareholding of the assessee company came to 3.75 lakhs at the end of 1966 and that the assessee had acquired 2 lakhs of J & P Coats (India) Pvt.Ltd. before 31.12.63 and 1200 shares of Madura Mills Co.Ltd. after 1.1.64. It is, therefore, contended that most of these shares having been acquired after 1.1.64, the question of exercising the option of adopting the fair market value of the shares as on 1.1.64 did not arise. However, perusal of the order of the ITO (Annexure-A) for the assessment year 1978-79 shows that only 1920 shares of Madura Mills Ltd. were acquired after 1.1.64. Other 2 lakhs shares of J & P Coats (India) Pvt.Ltd. and 3,75,000 shares of A & F Harvey were acquired before 1.1.64. Thus, the question of adopting the fair market value would, on the admission of the IT officer itself, apply to most of the shares except 1920 shares of Madura Mills Co.Ltd. which were acquired after 1.1.64.

18. We accordingly, remand the matter back to the Tribunal to give its findings after taking into consideration the observations of the Supreme Court **in**

the case of Commissioner of Wealth-Tax, Assam V/s. Mahadeo Jalan and Ors. reported in (**1972) 86 ITR 621** and on the basis of judgment reported in **(1994) 207 ITR 1 in the case of Bharat Hari Singhania and Ors. V/s. Commissioner of Wealth-Tax and Ors.**

(A.S. AGUIAR, J.) **(V.C. DAGA, J.)**